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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

**Agenda ID 12387
RESOLUTION G-3487
October 3, 2013**

R E S O L U T I O N

Resolution G-3487. Southern California Gas Company proposes criteria for determining whether baseload gas contracts for meeting Southern system reliability are reasonable and requests authorization to revise Rule No. 41 to incorporate these criteria.

PROPOSED OUTCOME: This Resolution approves Southern California Gas Company's proposed criteria and will allow the utility System Operator to enter into contracts meeting these criteria without prior commission approval. This resolution reduces the period of authorization for the revisions from five to three defined time periods; and clarifies when baseload contracts can be made for each of the defined time periods.

SAFETY CONSIDERATIONS: This resolution has an indirect positive impact on customer safety through its potential to reduce curtailments.

ESTIMATED COST: Estimated cost will depend on the gas purchase and sale prices in the market at the time.

By Advice Letter 4516 filed on July 1, 2013

SUMMARY

This resolution approves SoCalGas' proposed criteria for the reasonableness of baseload supply contracts for gas intended to support Southern System reliability with two modifications. This resolution also approves SoCalGas' proposed criteria for the subsequent sale of those gas volumes. This resolution reduces the period of authorization for the revisions from five to three defined time periods; and clarifies when baseload contracts can be made for each of the defined time periods.

Southern California Gas Company (SoCalGas) filed Advice Letter (AL) 4516 on July 1, 2013 requesting authorization to revise Rule No. 41. The revisions would enable SoCalGas to enter into “pre-approved” baseload supply contracts intended for Southern System reliability support if those contracts meet criteria derived from the Commission’s Resolution G-3477. The revisions propose reasonableness criteria for pre-approved contracts in five four-month periods (December through March) occurring between December of 2013 and March 31, 2018. The contracts would be deemed reasonable if they meet specified parameters for contract term, total volume, and price. The gas purchased through the contracts would be resold at the SoCalGas citygate. The revisions would also deem the subsequent sales of these volumes by SoCalGas reasonable if they meet the criteria used for other gas sales currently made under Rule No. 41.

This resolution approves the revisions to Rule No. 41 with: (1) a modification that the revisions only apply to the three four-month periods, falling between December 2013 and March 31, 2016; and, (2) a modification that clarifies when the contracts can be made.

The baseload contracts resulting from the revisions will have a potential indirect positive impact on safety. The contracts could assure supply of gas for a significant part of Southern System reliability requirements. As a result they will reduce the potential for curtailments of noncore customers, some of whom may provide essential services.

BACKGROUND

SoCalGas needs a certain minimum amount (which can vary depending upon conditions) of flowing supplies on its Southern System for the system to operate efficiently, safely and reliably. The SoCalGas Gas Acquisition Department (GA) had previously assured such flowing supplies using core customer assets. When GA needed to purchase additional spot supplies to meet minimum flow requirements at Ehrenberg, the eastern origin of the Southern System, its incremental costs to do so were recorded in a memorandum account.

In response to a SoCalGas/San Diego Gas & Electric/Southern California Edison Application to transfer this responsibility from GA, Decision (D.) 07-12-019

directed the System Operator (SO) to take over responsibility for managing Southern System minimum flow requirements as of April 1, 2009.¹

D.07-12-019 granted Applicants' proposal for a variety of System Operator Tools to manage minimum flow requirements. These included the authority to conduct requests for offers (RFO) or an open season process consistent with SO needs. Under its authority to conduct RFOs, SoCalGas has periodically solicited proposals to assist in managing its minimum flow requirements. Among the responses were proposals for baseload supply contracts which the Commission approved in 2009. As part of its approval, it required that the SO or the contract or transaction counterparty must pay an interruptible or firm access rights charge on any gas received.²

In July of 2012, SoCalGas conducted an RFO and received proposals for four baseload contracts for deliveries of natural gas at the Ehrenberg delivery point. SoCalGas requested approval of those contracts in AL 4399. The key provisions of the contracts were:

- Purchases by the SO of 280,000 dth/day (in total for all four contracts) at the Ehrenberg delivery point;
- Prices indexed to the Natural Gas Intelligence (NGI) SoCalGas border prices, plus 8.2 cents/dth; and,
- Payment for Backbone Transportation Service (BTS).

The purchased gas would then be resold by the SO at the SoCalGas Citygate. In its AL SoCalGas noted that although gas prices at the citygate typically carried a premium to those at the border, once the gas was resold at the citygate, a net cost to the SO would likely be incurred under the pricing term of the contracts, due to the payment of the 8.2 cents/dth premium and BTS charges.

¹ The SO is "broadly defined to constitute the SoCalGas departments responsible for the operation of its transmission system, including storage, hub services, pooling services receipt point access, offsystem deliveries, and system reliability. The System Operator functions explicitly exclude the Gas Procurement Department which will not be involved in any of the system-related operation activities." D.07-12-019.

² Resolution G-3435, September 10, 2009, p.33.

The Commission approved three of the proposed contracts with a combined volume of 255,000 dth/Day in Resolution G-3477.³ The resolution provided guidance to SoCalGas for the structure of future baseload contracts.

On July 1, 2013, SoCalGas filed AL 4516. In this AL, SoCalGas requests that during the next five years, baseload supply contracts that meet the criteria articulated by the Commission in Resolution G-3477⁴ as to the terms, pricing and volumes of the three baseload contracts should be deemed to be reasonable. Rule no. 41 defines the process that the SoCalGas SO follows for purchasing supplies to maintain minimum flows on the Southern System. SoCalGas requests that purchases under the contracts that meet the following criteria should be deemed to be reasonable if:

³ The three contracts approved provided for a total of 255,000 dth per day which the commission determined to be sufficient given projected needs. Approval of the fourth contract was conditioned based on whether the commission approved or did not approve a Memorandum in Lieu of Contract (MILC) between the SO and GA for additional supplies. The fourth contract was approved if the MILC, filed in a separate Advice Letter, was not approved.

⁴ Rule no. 41 defines the process that the SoCalGas SO follows for purchasing supplies to maintain minimum flows on the Southern System. The revision would insert a new Section 18 to the rule that reads: "Should the Operational Hub deem it necessary or advisable to enter into baseload contracts for Southern System support at one or more of the Southern System receipt points, the Operational Hub shall be deemed to have made reasonable baseload purchases if: (1) the total cumulative baseload volumes at any time are less than or equal to 255,000Dth/ day; (2) the price is less than or equal to NGI's Bidweek average for "Southern Cal. Bdr. Avg." plus 8.2 cents/Dth for the relevant baseload month(s); and (3) the term is for the December - March period, or any subset of that period. The Operational Hub shall be deemed to have made reasonable sales of such baseload gas if: (1) for baseload sales, the sale price is greater than or equal to 90% of NGI's Bidweek average for "SoCal Citygate" for the relevant baseload month(s); and (2) for spot sales, the sale price is greater than or equal to 90% of the ICE Wtd Avg Index for the relevant trading point and trading period. This provision shall expire on March 31, 2018, unless extended by the Commission. SoCalGas may seek extension or modification of this provision by standard advice filing application." A footnote to the proposed revision reads, "The NGI bidweek index was used for the baseload contracts approved by the Commission in Resolution G-3477. SoCalGas is proposing to use that same index for future baseload purchases, as well as sales done on a baseload basis. Spot sales of baseload gas would be judged by the same ICE weighted average as spot sales under Rule No. 41 Section 13 a. SoCalGas Advice No. 4516, Revisions to Rule No. 41, Utility System Operation, July, 1, 2013, p. 4 and footnote 9.

- Their cumulative volume is less than or equal to 255,000 dth/ day;
- The price is less than or equal to NGI's Bidweek SoCalGas Border price average⁵ plus 8.2 cents/ dth
- The term of the contract is for some or all of the period of December through March.⁶

The gas would be resold by the SO. In AL 4516 SoCalGas also proposes that such sales would be deemed reasonable if:

- For baseload sales, the price is greater than or equal to 90% of NGI's Bidweek average for the SoCal Citygate; and/or
- For spot sales, the price is greater than or equal to 90% of the International Exchange (ICE) Weighted average Index.

SoCalGas asserts that there are several advantages to the Rule No. 41 revisions that result in preapproval of baseload contracts. Among these are:

- (1) preapproval avoids issues related to the timing of Commission approval of contracts and the willingness of suppliers to hold their price commitments pending approval;
- (2) preapproval will enable SoCalGas to obtain better pricing for baseload contracts since suppliers will not add a risk premium to reflect risk related to regulatory approval; and
- (3) counterparty knowledge of the volume, price and term limits will not jeopardize achieving the best terms since multiple potential suppliers will compete against each other, not just the tariff criteria.

NOTICE

Notice of AL 4516 was made by publication in the Commission's Daily Calendar. SoCalGas states that a copy of the Advice Letter is being sent to the parties listed

⁵ The Bidweek SoCalGas Border index represents a monthly fixed price of gas that will flow every day during the forthcoming calendar month ("baseload" transactions). NGI's Price Index Methodology Point-By-Point Index Descriptions and Code of Conduct Statement. July 2012, p. 2.

⁶ The AL does not make clear whether SoCalGas could enter, at one time, e.g. in 2013, agreements for all of the future periods or if they can only be entered separately in each of the years in which the period begins. This is discussed in the Discussion section of this Resolution.

on Attachment A to the Advice Letter which includes parties in the 2009 Biennial Cost Allocation Proceeding, A.08-02-001, and the 2013 Triennial Cost Allocation Proceeding, A.11-11-002.

PROTESTS

AL 4516 was timely protested by the Indicated Producers (IP)⁷ and the Southern California Generation Coalition (SCGC). IP filed a protest to AL 4516 on July 22, 2013. The protest expresses support for AL 4516 subject to “a reduction in the authorization period for pre-approved baseload contracts from five years to three years.”⁸ Additionally, the protest seeks clarification that the term of authorization in the AL refers to the purchase and receipt of supply under any baseload contract and not to the authorization of any contract that would allow for purchase and receipt of supply after March 31, 2013.

The Southern California Generation Coalition (SCGC) filed a protest of AL 4516 on July 17, 2013. As with the IP protest, the SCGC protest does not oppose pre-approval of baseload contracts but does seek to limit the period during which SoCalGas can enter into the contracts from SoCalGas’s proposed five years to three years.

On July 29, 2013, SoCalGas filed a reply to the protests of IP and SCGC. In its’ reply SoCalGas states that it “does not object to limiting the initial authorization period for the new baseload contract provisions to three years.”⁹

⁷ The Indicated Producers include Chevron U.S.A. Inc., BP Energy Co., ConocoPhillips Company and Occidental Energy Marketing Inc.

⁸ The IP protest filed on July 22, 2013 contained a typographical error on page 2 where it asked for a two year authorization period rather than the three years indicated on page 1 of the protest. This error was corrected and a corrected copy of the protest was submitted on August 1, 2013. Protest of the Indicated Producers to Southern California Gas Company Advice Letter 4516. July 22, 2013, pp. 1-2; and corrected copy submitted via email on August 1, 2013, p. 2.

⁹ The SoCalGas reply was filed before the IP submitted a revision correcting its typographical error. As such the reply commented on the apparent conflict in the protest which recommends on page one that the authorization period be limited to three years and then states that it would support a period of two years on page two. The reply also stated its objection to the shorter, two year period. IP has provided SoCalGas with a new copy of the protest correcting the typographical error. Reply to Protests of SoCalGas Advice No. (AL) 4516 – Revisions to Rule No. 41, Utility System Operation. July 29, 2013, pp. 1-2.

The reply also responded to IP's request for clarification of the term of authorization. SoCalGas clarified that it is proposing that the sunset date for the baseload contract criteria would apply to the actual delivery of supplies under baseload contracts.

DISCUSSION

Baseload contracts are a useful tool to meet Southern System minimum flow requirements and should be made available for use when appropriate. As presented in Resolution G-3477, properly structured baseload contracts have been a cost effective method of managing Southern System minimum flow requirements. However, because they involve pricing in a dynamic commodity market, the nature of negotiating, accepting and executing these contracts is necessarily time sensitive.

Requests for approval of baseload contracts have been made through the Advice Letter process. While this process can afford timely approval, the specifics of a given contract may require non-routine analysis and review thus prolonging the process. Further, a protest to the AL, not otherwise rejected, can extend the review process that may or may not end in the approval of the proposed contracts. As a result, a beneficial contract(s) may not be approved in time to be executed.¹⁰ Additionally, as suggested by SoCalGas in AL 4516, it is reasonable to expect that suppliers will add a risk premium reflecting the uncertainty consistent with a more lengthy process. Preapproval of the contacts will eliminate the potential delays and any associated risk premium added to reflect the potential for delay.

Preapproval for baseload contracts that meet specified criteria provides for a SO tool that can be efficient and effective in meeting Southern System minimum flow requirements and managing Southern System reliability. Pre-approval of contracts avoids potential delays inherent in a year-by-year filing and approval process. Preapproval provides flexibility to use baseload contracts

¹⁰ AL 4399, filed in August of 2012, requested approval of four baseload contracts to be used to meet Southern System minimum flow requirements. The Commission determined that three, and under certain circumstances the fourth contract, were appropriate and approved the contracts. However, a combination of necessary review and analysis, protests to the AL and internal review for approval did not allow for the timely execution of the contracts.

in conjunction with other SO tools to efficiently and effectively meet Southern System minimum flow requirements and manage system reliability.

Preapproval of baseload contracts should require that the contracts meet specific criteria in order to be determined reasonable. In Resolution G-3477 the Commission provided guidance concerning the basis on which it would approve any proposed future contracts. SoCalGas has incorporated the Commission's direction in its proposal. In Resolution G-3477 the Commission provided guidance concerning the basis on which it would approve any proposed future contracts. SoCalGas has incorporated, in its proposed revisions to Rule 41, the Commission's direction as a basis for defining the reasonableness of baseload contracts. The proposed revisions incorporate criteria defining the reasonableness of baseload purchases and spot and baseload resale of the gas supplied through the contracts. These resale criteria are consistent with those already applied under Rule No. 41 to resales of other gas supplies purchased to support Southern System minimum flow requirements.

In its review of the baseload contracts presented in Resolution G-3477, the Commission determined that, when used in conjunction with other tools available to it and requested for use, baseload contracts in the amount of 255,000 would provide in excess of 90% of projected needs.¹¹ Allowing for amounts significantly over 255,000 would potentially result in excess supply. With this in mind, AL 4516 capped the total supply at 255,000 dth/day. The proposed revisions to Rule 41 also use, as a basis for determining the reasonableness of purchase prices, the same mechanism used in the contracts approved in Resolution G-3477, that is, the NGI Bidweek average for the SoCal border price plus 8.2 cents/dth. This pricing would have been very favorable had the contracts proposed for December 2012 through March 2013 winter season been executed. The maximum term of the contracts, the four months of December

¹¹ A Memorandum In Lieu of Contract (MILC) between the SO and GA already ensured that a significant portion of Southern System minimum requirements would be met. SoCalGas has used Commission-approved MILC's twice in the past and has requested the use of a third MILC in AL 4523 filed on July 25, 2013. These agreements provide that, in effect, approximately one half of the Southern System minimum flow requirement will be met. The MILC combined with the use of baseload contracts for 255,000 dth/day will provide for over 90% of projected minimum flow requirements.

through March also mirrors the term of the previously approved contracts.¹² Finally, as stated above, the criteria applied to determine the reasonableness of sales is the same as that in use for other sales under Rule No. 41.

The authorization for preapproval should only cover the next three winter periods, consisting of the months December through March, commencing with December of 2013 and ending in March of 2016. We agree with both the protests of SCGC and the IP on limiting authorization period for preapproval to three winter seasons. Both protests make the argument succinctly expressed by IP that, "Limiting the term will allow stakeholders a reasonable and timely opportunity for review."¹³ As expanded upon by the SCGC, "...reassessment would be appropriate after three years. Natural gas supply patterns are changing rapidly [in] North America due to the development of shale gas. Likewise, usage patterns on the SoCalGas Southern System are likely to change, particularly as a result of the closure of the San Onofre Nuclear Generating Station ("SONGS"). Sunsetting the preapproval and safe harbor provisions in three years, without prejudice to an extension if warranted, would trigger a review of the preapproved safe harbor provisions in light of potentially new gas supply patterns and new usage patterns."¹⁴ SCGC notes that the three years would also allow for a timely discussion by stakeholders at the SoCalGas Customer Forum in May, 2016 while providing sufficient time to submit a new filing for an extension of the contract criteria based on conditions at that time. Recent filings and discussions with SoCalGas make clear the dynamic nature of the operating environment and particularly within the Southern System. By way of illustration, a staff review of the SoCalGas citygate price premium to border price notes that it has varied somewhat over the last three years, and a review of minimum flow requirements indicate that they have grown on a year to year basis.

¹² Per footnote 6, further clarification is required regarding the term of the contracts. This is discussed in following paragraphs.

¹³ Protest of the Indicated Producers to Southern California Gas Company Advice Letter 4516. July 22, 2013, p.2.

¹⁴ Southern California Gas Company Advice Letter No. 4516, Revisions to Rule No. 41, Utility system Operation Pre-approval of Baseload and Save Harbor for Citygate Sales. Protest by IP. July 17, 2013, p. 3.

Preapproval using the proposed criteria for the three periods provides the flexibility to execute contracts on a timely basis. Additionally, the authorization period provides further opportunity to assess the effectiveness of baseload contracts, if used, and especially their use in conjunction with other approved tools. Finally, the dynamics of market demand, supply and pricing may, over time, require differing criteria. Three periods represents a practical balance between the need to define and implement ongoing criteria and the need to assess and reevaluate the criteria in a dynamic market environment.

Consistent with the need to operate in a dynamic market, the revisions should clarify that SoCalGas can only enter into contracts for one season at a time.

While it is unlikely that SoCalGas could enter into a contract for multiple seasons, the revisions to Rule 41 should incorporate language clarifying that the revisions will only allow SoCalGas to enter into contracts for one season at a time and only within the 9 month period directly preceding that season.

As currently presented the revisions would allow SoCalGas to enter into contracts at one time, for example, in 2013, that would apply to all of the subsequent seasons falling under the authorization period. Given that the market is constantly changing, such an approach is not practical. In response to an Energy Division data request SoCalGas acknowledged that the revisions would allow it to execute a single contract applying to all (or some) of the four month periods during the authorization period. SoCalGas also commented that while possible it would not be likely that a party would enter into a contract with SoCalGas for more than a year out. SoCalGas also indicated that a clarification could be made.

While, as the protests note, three four-month periods will provide an appropriate amount of experience for review of the effectiveness of the proposed Rule No. 41 revisions, the Commission finds that SoCalGas should provide, as part of its Annual Compliance Review, an assessment of the baseload contracts. The assessment should include a narrative discussion of the use of the contracts supported by quantitative analyses. The discussion should address whether an RFO was issued (and the circumstances leading to issuing or not issuing an RFO), the level of response to any RFO, considering both baseload and other contract types, and the range of pricing in the contracts. Further, the discussion and analysis should address costs of the contracts in general and relative to other tools (e.g. spot purchases) as well as overall efficiency and effectiveness of the contracts. Finally the discussion should identify any issues, opportunities or problems that may impact the use of baseload contracts in future years or suggest further revisions to Rule No. 41.

COMMENTS

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

The Commission advised each of the parties of the modifications that it requires for approval of AL 4516 and requested that the 30-day comment period be waived.

All parties in the proceeding have stipulated to waive the 30-day waiting period required by PU Code section 311 (g)(1) and the opportunity to file comments on the draft resolution. Accordingly, this matter will be placed on the Commission's agenda directly for prompt action.

FINDINGS AND CONCLUSIONS

1. Baseload contracts are an efficient and effective tool to help meet Southern System minimum flow requirements and manage reliability.
2. A dynamic market makes approval and execution of these contracts time sensitive. When requests concerning baseload contracts are filed on a year-by-year basis, the Commission approval process, under certain circumstances, does not always allow for approval in a timeframe necessary to execute the contracts.
3. Advice Letter 4516 proposes criteria concerning contract term, purchase price and volumes; and criteria governing resale prices that can be used to determine the reasonableness of baseload contracts and the resale of gas acquired through the purchases.
4. The criteria for the contracts proposed as revisions to Rule No. 41 reflect Commission direction provided in Resolution G-3477 with regard to term, volume and purchase prices.
5. The proposed revisions to Rule No. 41 establishing criteria to determine the reasonableness of the prices for resale of gas acquired under baseload contracts meet criteria used for other sales of gas under Rule No. 41.
6. The proposed revisions to Rule No. 41 provide a framework consistent with prior Commission direction and consistent with existing Rule No. 41 sales criteria, to “pre-approve” baseload contracts that conform to the criteria

presented in the revisions. Approval of the revisions effectively overcomes issues concerning the timeliness of the approval process.

7. The authorization period for the revisions, from December of 2013 through March of 2018 is unnecessarily long. A shorter time covering three four-month periods of December through March that occur between December of 2013 and the end of March, 2016, is appropriate. This timeframe balances the need for preapproval with the need to review and evaluate the effectiveness of the contracts. The revisions should be modified to reflect this shorter timeframe.
8. With a modification shortening the authorization period, the proposed revisions represent an effective way to implement baseload contracts.
9. The proposed revisions would allow for a single contract covering all of the four month periods falling within the authorization period. This aspect of the revisions is not practical in a dynamic market. The revisions should be modified to limit Southern California Gas to only enter into contracts for one season at a time and only within the nine month period preceding that season.
10. A full review of the use of baseload contracts under revisions to Rule No. 41 and discussion with stakeholders should take place at the Southern California Gas Annual Customer Forum in 2016. Annual assessments and evaluation, including an indication of issues or possible further revisions should be included in each of the Southern California Gas Annual Compliance Reports for 2013/14, 2014/15 and 2015/16.

THEREFORE IT IS ORDERED THAT:

1. The request of the Southern California Gas Company to revise Rule No. 41 as requested in Advice Letter AL 4516 is approved subject to modification.
2. Southern California Gas Company shall, within 30 days, file a supplement to Advice Letter 4516: (1) modifying the language proposed for Section 18 of Rule No. 41 to state that the provision will “expire on March 31, 2016, unless extended by the Commission;” and (2) adding language to Rule No. 41 that contracts can only be made for one season at a time and only within the nine month period directly preceding that season.
3. Southern California Gas Company shall incorporate an assessment and evaluation of the use of baseload contracts in each of its Annual Compliance Reports for the years 2013/14, 2014/15 and 2015/16; and provide for a

discussion of the use of baseload contracts for the Southern System at its Customer Forum in 2016.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on October 3, 2013 the following Commissioners voting favorably thereon:

Paul Clanon
Executive Director